



An Innovative Technology Company Providing
Custom Energy and Emission Reduction Solutions

▶ Fiscal Year 2007

Annual Report to Shareholders



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President's Message to Shareholders

Dear Thermal Energy shareholders;

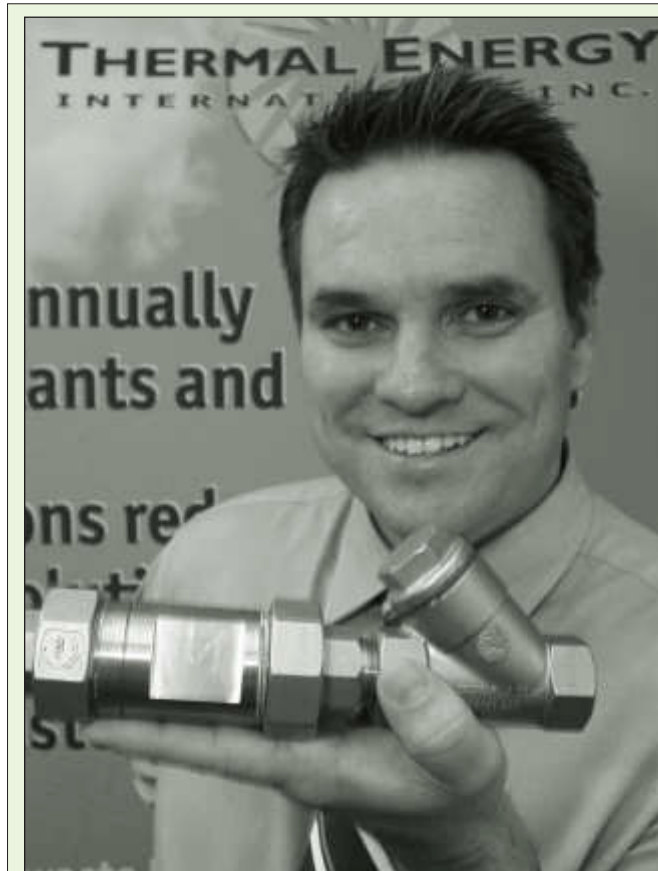
Fiscal Year 2007 was a year where we continued to make excellent progress in the transformation of Thermal Energy into a competitive player in the alternative energy space with compelling solutions for reducing energy costs and providing excellent environmental benefits.

With the integration of new technologies and solutions, major penetration into the U.S. market and taking our first steps into the enormous Chinese energy solutions and pollution control market, institutional financing, key advances in our research and development efforts, and a new, innovative financing alternative for customers, management and staff had a very busy year.

Translating this into financial results took several quarters longer than we had anticipated, largely due to delays of several months in the closing of our first two major U.S. contracts through Johnson Controls, Inc. with Global 500 customers, which resulted in revenues below last year's record year. However, we did sign contracts for approximately \$3.9 million in sales - another record - with approximately \$3 million in revenue to be recognized in Fiscal 2008. This is the first time Thermal Energy has entered a new fiscal year with such a revenue backlog. With additional contracts in sight as the year ended, our efforts this fiscal year have set the stage for an exciting year for shareholders in FY 2008 with continued anticipated record growth.

From the standpoint of executing on our business plan, I believe Thermal Energy has reached the "tipping point" for continued steady growth with business activity on several fronts. Thermal Energy enters Fiscal 2008 in a better fiscal position than at any other time in its history. The \$1.3

million private placement conducted with Whitebox Advisors in the U.S. and a Toronto hedge fund, put some financial stability under the company in addition to enabling the expansion of our sales and marketing activities.



Thermal Energy President and CEO Tim Angus displays one of the new GEM steam traps which have proved quite popular with customers since the Company acquired an exclusive licence for the technology for Canada and key U.S. industrial markets. The GEM traps have a 10-year no-fail guarantee - unprecedented in the steam trap industry.

Pipeline Growth

Another indicator of our growth is the continued increase in the size of our sales pipeline. The pipeline is an estimate of qualified projects which are in various stages of discussion with prospective clients, including repeat business identified with existing clients but not yet contracted. This pipeline of prospects grew from less than \$5 million in FY 2005 to approximately \$40 million in FY 2006 and stood at more than \$70 million at the end of FY2007. By the end of our first quarter of Fiscal 2008, the pipeline is expected to be in excess of

\$100 million. At last year's annual meeting I expressed my commitment in having the Company continue to grow the pipeline of qualified opportunities. We were also confident in raising the bar and establishing a goal of converting between 7% to 10% of this pipeline into contracts at any given time. We are pleased with the results thus far and are on track to achieve this new target. In Fiscal 2008, we have placed a significant focus on growing our sales and marketing capabilities and as such have revised our pipeline conversion goal to a 12% to 15% rate for Fiscal 2009, while also continuing to grow the pipeline of qualified opportunities. We are optimistic that this growth strategy will provide for continued success and favourable financial results for Fiscal 2009.

There were two developments during the year which we believe provide exceptional near-term growth opportunities for Thermal Energy.

DRY-REX™ Acquisition

The first of these was the acquisition of the DRY-REX™ low temperature biomass technology which we see becoming a new flagship technology for Thermal Energy, enabling our entry into the new and exciting biomass and biofuel markets. The waste-to-energy markets are in their infancy but seen as rapid growth areas. The DRY-REX™ system is highly complementary to our FLU-ACE® waste heat recovery technology, which provides an ideal source of low-grade heat - in effect "free" heat - to effect the drying process for everything from pulp and paper sludge and wood waste to, potentially, municipal solid waste and sewage sludge. When wet waste is dried before burning or combustion, it is transformed from a low-yield, inefficient fuel stock, into a high-yield, high heat value green fuel which can be used to offset the consumption of fossil fuels. In many

instances, DRY-REX™ also provides substantial environmental benefits by reducing or eliminating landfill requirements for these materials. We think Thermal Energy is in the right place at the right time with this technology and we are optimistic of the future growth potential it represents in a multitude of industrial markets ranging from pulp and paper, to food and beverage, and ethanol production.

THERMAL-AUD™

The second development is one which we think will help us get past the restrictive decision making process for large expenditure products with our prospective customer base. Inside our annual report, you'll find the details on our new THERMAL-AUD™ Alternative Utility Delivery Program, which provides customers the flexibility of benefiting from energy savings outside the restrictive process of their corporate capital expenditure cycles. This major initiative led by Denis Forget, who was named Chief Operating Officer this year, led to Thermal Energy establishing its wholly-owned energy services subsidiary ForEverGreen Energy Inc. In early Fiscal 2008, this has already produced one energy services agreement worth up to \$3.75 million based on a FLU-ACE® waste heat recovery system and a Letter of Intent expected to lead to another major energy services contract based on the DRY-REX™ biomass drying system. Revenue anticipated from these projects would be on top of the \$3 million backlog to be recorded in FY2008.

In terms of our long-term growth, this year Thermal Energy took its first steps into

China - the world's largest and fastest-growing market in terms of industrial growth and energy needs. Our research and development agreement with South China University of Technology (SCUT) presents a wonderful opportunity to prove out and commercialize our THERMALONOX™ process to remove nitrogen oxides (NOx) from coal-fired power plant emissions over the next couple of years.

this year. We welcomed William Crossland to the Board and look forward to benefiting from his years of experience and financial acumen following many years in senior and executive positions at the National Bank of Canada in corporate finance.

Last but not least, none of the accomplishments of the past year would have been possible without the tireless efforts of our small, but highly dedicated team of employees who, time and time again, have demonstrated talents and capabilities that equal and even best those of the largest energy services and engineering firms in the world. Equally worthy of praise are our shareholders, many of which have stood with us for many years and continue to share our enthusiasm and vision for the future of this company. I also want to extend a sincere welcome to all of our new shareholders this past year and look forward to a rewarding future with all of you as well.

Thermal Energy enters FY 2008 in a better

financial position than at any other time in our history. We continue to work very hard at delivering on the strategic plan carefully developed and put in place by our management team and Board of Directors over the past two years. We look forward to continuing to share the results of our efforts with our shareholders and providing you increased value and reward for your support.

Sincerely,



Tim Angus
President and CEO
October 25, 2007



Guangzhou, CHINA -Thermal Energy International CEO Tim Angus (left) and Deng Feigi, Deputy Director, Science and Technology, South China University of Technology (right) sign an R&D agreement for TEI's THERMALONOX™ nitrogen oxides (NOx) reduction technology for coal-fired power plants as officials from SCUT, the governments of Guangzhou and Guangdong, and the Canadian government look on.

China Market Entry

China also represents an untapped market for our existing energy saving technologies such as FLU-ACE®, GEM® and DRY-REX™. We have started down the right path to finding the best joint venture partners to properly tackle this market which has already demonstrated an eager appetite for our solutions. Our early success in this regard has been demonstrated by the significant initial order for GEM® steam traps from Lee and Man Paper Manufacturing Co., one of the largest paper manufacturers in the world.

I would also like to take this opportunity to note a change to our Board of Directors

ForEverGreen Energy Inc. A New Business Model for TEI

Thermal Energy established ForEverGreen Energy Inc. (FEI) in 2007 as a wholly-owned subsidiary to provide a vehicle for executing energy services agreements based on the THERMAL-AUD™ Alternate Utility Delivery Program with customers.

ForEverGreen provides excellent strategic value and benefits for Thermal Energy on a number of fronts. As one of the selling points of THERMAL-AUD™, ForEverGreen provides the capacity to isolate and limit risk to Thermal Energy and shareholders. Investments and the need to raise capital for the purchase of energy saving equipment for the projects, such as FLU-ACE® or DRY-REX™ systems reside with FEI. Thermal Energy will invest some equity in the FEI projects as required on a project finance basis while securing the remaining funds through debt from bank loans or other third party investments in FEI secured by the assets and long term purchase agreements with its customers. While this will require some TEI equity, the returns generated from these investments and projects fully justify the requirement for the funds and begins the process of focusing TEI's outlook towards long term investments and increased shareholder value.

THERMAL-AUD™ agreements typically run for five to 12 years, with either a renewal or the sale of the energy saving assets to the customer at fair market value at the end of the agreement term. Thermal Energy is responsible for, and derives revenues from, the initial installation of the facilities as well as the management of the performance of the installations throughout the life of the agreement.

Typical steps in an FEI THERMAL-AUD™ Service Agreement:

1. FEI signs customer to a THERMAL-AUD™ energy services contract;
2. FEI secures the capital to purchase equipment from Thermal Energy, i.e.: Bank loans, private equity (as required), TEI equity and/or partners;
3. FEI purchases equipment from TEI;
4. FEI pays TEI to implement and manage the performance of the facilities throughout the term of the agreement;
5. Customer pays FEI according to terms of contract;
6. At the end of the contract, the customer has purchase and renewal options that can be exercised or FEI can remove and relocate its equipment.

Project spotlight:

Thermal Energy worked with a major U.S. fluorescent tube manufacturer at the largest facility of its kind in the world, to apply innovative waste heat recovery and steam efficiency technologies to reduce energy costs.

This \$2.5 million project represented a series of firsts for Thermal Energy:

- The first major commercial contract in the U.S.;
- The first major waste heat recovery project utilizing non-FLU-ACE® technologies;
- The first major retrofit undertaken by Thermal Energy utilizing the newly-acquired GEM® Condensate Return System technology.

A comprehensive engineering and feasibility study by Thermal Energy identified two separate energy saving projects at the facility in addition to the steam trap retrofit with the GEM® technology.

The first energy saving measure involved recovering waste heat from oven exhausts to heat air required in the light bulb drying process. The second energy efficiency measure involved using waste heat from the glass furnace exhaust to generate steam for use in various processes at the plant.

This was augmented by retrofitting the steam plant with the GEM® Condensate Return System. This involved completely retrofitting the production facility condensate return system with GEM® traps eliminating an annual failure rate of 14% resulting in significant steam production maintenance cost savings.

Project spotlight: Global 500 food producer

During Fiscal 2007, Thermal Energy received its second U.S. commercial contract to implement a heat recovery/energy cost reduction project for a Global 500 food and beverage producer at a cereal manufacturing plant.

The challenge was to build on energy efficiency measures previously implemented by the company. For instance, stack economizers were already in place on the three boilers to recover heat for pre-heating boiler feedwater.

Despite such measures, Thermal Energy determined there were still large quantities of energy being wasted which amounted to approximately 15% of the fuel energy purchased annually.

Thermal Energy installed a FLU-ACE® waste heat recovery system to capture waste energy from the plant's combined boiler exhausts and a new heat distribution system was installed to transfer the recovered energy to various process water flows within the plant to further reduce site energy consumption.

Completed in September, the project saves the manufacturer approximately \$600,000 a year in fuel energy costs which also results in a decrease in annual emissions of 3,000 tons of CO₂ and 4 tons of nitrogen oxides (NO_x).

Thermal Energy is in the process of completing preliminary work on a second project at another of the company's plants.



Thermal Energy installed a new FLU-ACE® waste heat recovery system (opposite page) and new large-scale duct work for an international food and beverage producer at one of its U.S. facilities.

U.S. fluorescent light maker

Once completed, the project will result in annual energy savings of approximately \$800,000 through reducing fuel consumption which also results in a decrease in annual emissions of 4,740 tons of CO₂ and 11 tons of nitrogen oxides (NO_x). The project is expected to be completed in spring of 2008.

Before and after pictures showing the impact of the energy saving measures such as GEM steam traps (below) applied at a large U.S. fluorescent light manufacturing facility.



THERMAL-AUD™ An Innovative Alternate Utility Delivery Plan

Thermal Energy's THERMAL-AUD™ Program is an innovative, off-balance sheet product that allows energy managers to meet corporate energy cost and emission reduction mandates without investing internal capital funds.

THERMAL-AUD™ provides compelling reasons for customers to accelerate their adoption of energy savings solutions which might otherwise be delayed under traditional capital expenditure budgeting. THERMAL-AUD™ offers:

- Energy cost and emission reductions as a program

- No capital required, no balance sheet impact
- Program in place ready for review, faster implementation through elimination of capital budgeting process.
- Risks for equipment maintenance, repair, performance, downtime and financing costs transferred to TEI through THERMAL-AUD™ program.
- Applicable to all types of TEI and non TEI technology solutions.

Introduced in the last year, THERMAL-AUD™ has already yielded its first contract with Fraser Papers' Thurso Mill worth up to \$3.75 million over six years. The project will see the installation of a FLU-ACE® waste heat recovery system at the mill in western Quebec, which will be owned and operated by Thermal Energy's new subsidiary ForEverGreen Energy Inc. (opposite page).

"This initiative will improve our energy efficiency and strengthens our environmental position at our pulp and paper facilities," said Jean Pierre Benoit, General Manager at the Thurso pulp mill. "Fraser Papers' Thurso operation is committed to improving its environmental performance in all aspects of our operations."

A recently signed letter of intent involves utilizing a DRY-REX™ low-temperature drying system to turn a pulp and paper mill's waste stream into a replacement for fossil fuels. A feasibility study is slated for Fiscal 2008. Based on the customer's positive review and acceptance it would lead to a second contract under the THERMAL-AUD™ business model.



Thermal Energy Highlights Fiscal 2007

July 10, 2006 - Thermal Energy hires six experienced sales representatives covering territories from North to South America, enhancing sales capacity

September 11, 2006 - Thermal Energy acquires the award-winning, patented DRY-REX™ bioenergy technology from Mabarex Inc., of Montreal

December 1, 2006 - Thermal Energy announces it will be implementing a heat recovery/energy cost reduction project in the U.S. in the food and beverage sector.

January 31, 2007 - Thermal Energy receives a \$2.5 million contract to implement waste heat recovery and steam system improvements at a major U.S. industrial facility.

February 9, 2007 - Thermal Energy's FLU-ACE® waste heat recovery wins two awards, one for energy conservation from the Pulp and Paper Technical Association of Canada (PAPTAC), and a Project Merit Award from the U.S.-based Environmental Business Journal for the FLU-ACE project at Minas Basin Pulp and Power Co.

April 3, 2007 - The final patent applications are filed on new technology at the core of the THERMALONOX™ nitrogen oxides (NO_x) reduction solution.

April 10, 2007 - An agreement is signed with the South China University of Technology (SCUT), with Chinese government backing, to research and develop industrial applications for Thermal Energy's THERMALONOX™ nitrogen oxides (NO_x) removal technology.

May 16, 2007 - The Company closes its first institutional U.S. financing for \$1 million, later increased to \$1.3 million, with a syndicate of investment firms including Whitebox Investment Advisors LLC, an SEC-registered investment advisor with over \$2 billion in assets, headquartered in Minneapolis, and with a Toronto investment firm.

May 31, 2007 - William M. Crossland joins Thermal Energy's Board of Directors, bringing 20 years of expertise in major financing and M&A activity, most of it with the National Bank of Canada's Corporate and Investment Banking Group.

Financial Information

MANAGEMENT'S DISCUSSION & ANALYSIS - 2007

Overview

This discussion explains the material changes in the Company's financial condition and results of operations for the fiscal year ended May 31, 2007 (or FY 2007), and compares the FY 2007 financial results to the previous year ended May 31, 2006 (or FY 2006). The consolidated financial statements, and notes to the consolidated financial statements constitute an integral part of the discussion and should be read in conjunction with these comments. This discussion and analysis of the financial condition and results of operations may contain forward-looking statements. These statements are not guarantees of future performance and are subject to risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

Thermal Energy has established itself since 1991 as a leading provider of cost-effective energy conservation and environmental compliance (air) products and solutions. Thermal Energy is providing its integrated turnkey solutions for customers to economically reduce multiple air pollutant emissions while deriving substantial energy savings benefits through advanced heat recycling. Thermal Energy's innovative abilities and unique technologies have ensured that the implemented solutions met or exceeded the air pollution control performance expectations, while at the same time generated sufficient renewable energy and operating cost savings to produce an attractive return on investment ("ROI"), thereby causing the solution to be self-financing.

Thermal Energy has developed cost-effective energy conservation and air compliance solutions for efficiently removing and reducing multiple air pollutant emissions including: Nitrogen Oxides (NOx) "Smog", Sulfur Oxides (SOx) "Acid Rain", Carbon Dioxide (CO2) "Greenhouse Gas", Fine Particulate Matter (PM2.5) "Lung Irritants", Heavy Metals (HM) including Mercury (Hg) "Carcinogenic Bio-accumulators", Toxic Organic Compounds (TOC) "Poisonous", and Volatile Organic Compounds (VOC) "Odorous or Toxic".

More information on Thermal Energy can be found at www.thermalenergy.com. FLU-ACE®, THERMALONOX™, THERMALOZOMAX™ and DRY-REX™ are registered trademarks of Thermal Energy. Common shares of Thermal Energy are traded on the TSX Venture Exchange under the symbol TMG.

Environmental Compliance and Energy Conservation Market Trends

World market demand is increasing for innovative environmental protection and renewable energy solutions for sustainable economic growth. North America today is faced with the growing challenge of reducing and controlling air pollution emissions that cause serious health risk to human beings, cross international borders, and impact the environment. Furthermore, as the USA, Europe ("EU"), and Canada strive to grow their economies and increase their economic outputs, this causes increased demand and consumption of fossil fuels. Therefore, the more successful a country becomes, the larger the task and costs are for the reduction and the control of multiple air pollutant emissions from fossil fuel consumption. In addition, the costs of oil and natural gas fossil fuel energy sources have been rising substantially both due to the increasing demand for their utilization, and due to the decreasing fossil fuel reserves and sources which are available for consumption. Thermal Energy has developed and commercialized proprietary air compliance and waste heat recovery technologies and solutions, designed specifically to cost-effectively meet or exceed both the current and future anticipated US and EU air pollution emissions regulations.

Thermal Energy is well positioned to provide the US, EU, and Canada with the best available products, technologies, and solutions to most economically meet both the medium-term and longer-term air compliance and energy conservation objectives. In addition to having cost effective environmental compliance and energy conservation solutions, Thermal

Energy continues to grow and work through strategic alliances, cooperative partnerships, and synergistic sales development associations with US and Canadian companies in order to sell, market, and implement retrofit solutions in North America. Recently, the Corporation established new strategic alliances and cooperative relationships with companies in China to further improve the Corporation's competitive access to global markets.

Through unique energy conservation and self-financing solutions, Thermal Energy is economically assisting in meeting Canadian, and soon US, and EU environment protection policies, strategies and goals to achieve cost effective environmental compliance.

Energy Conservation and Environmental Compliance Solutions Business

Thermal's technologies have widespread industrial, utility, commercial and institutional applications for environmental compliance, self-funding energy retrofits and infrastructure upgrades to plant operations. Specifically the technologies can be applied to process modifications and retrofit solutions for primary metal processing, automotive manufacturing, coal-fired power utility, petrochemical, pulp & paper, and food processing industries as well as for sewage treatment, central or district heating, commercial building, and institutional facilities. In addition, Thermal Energy has developed leading edge energy-from-waste solutions for combustion of solid and liquid waste via incineration and thermal destruction facilities.

The Corporation delivers superior proprietary and patented environmental compliance and energy conservation technologies coupled with comprehensive engineering and implementation services. The Corporation has two main product lines, the first of which is the proven FLU-ACE® condensing reactive exhaust gas scrubbing technology, and the second is the patent pending THERMALONOX™ technology under development to reduce nitrogen oxide emissions for coal-fired utilities and heavy industry. Hybrid Multi-Air Pollutant FLU-ACE® is the only known multi-air pollutant removal system on the market to effectively combine efficient energy recovery with air pollution control into one easy solution. The unique benefits of combined energy savings and air pollution control give the FLU-ACE® family of products and integrated systems solutions a large competitive advantage in the marketplace. More information may be found on the Corporation's products, technologies and solutions by visiting the website at www.thermalenergy.com.

Throughout FY 2007 the Corporation maintained its strategic cooperation agreement with Johnson Controls L.P. ("JCLP") for developing combined energy conservation and air pollution control solutions for their selected Canadian and U.S. customers. However, although JCLP accounted for nearly all of the sales in FY 2004, FY 2005, FY 2006 and FY 2007, the Corporation continues to work aggressively with other new and potential partners to attract new customers. An example of such a new arrangement was the signing of a Memorandum of Understanding in Q1 FY 2008 to develop a joint venture with the Jiangnan Boilers and Pressure Vessels Company, Ltd. (JBPV), to deploy the Corporation's energy recovery solutions in key Chinese markets. JBPV with revenues of \$90 million annually serves the chemical fertilizer, medical, oil and chemical industries in China and works with a number of international companies such as York International, BASF, SECCO, Inc., and SPX Corp. As a result, management is confident that the Corporation would continue in the absence of contracts with JCLP.

During the past year, the Corporation completed the implementation of its second Hybrid FLU-ACE® solution for JCLP at the Minas Basin Pulp and Power Co.'s facility in Nova Scotia, Canada. In addition it was successful in signing and starting work on two heat recovery projects for JCLP's US-based clients, (the first such contracts in the U.S.). The first involved the implementation of a heat recovery/energy cost reduction project at a major food and beverage facility in the U.S. for an estimated value in excess of \$1.4 million. The second commercial contract in the U.S. market is also the first to use both the Company's FLU-ACE® waste heat recovery solutions and its new state-of-the-art GEM® Condensate Return System. The Corporation also successfully completed the engineering design and

Financial Information (Cont'd)

supply of its FLU-ACE® Condensing Heat Recovery Major Equipment Package at Mere-Enfant for the Centre Hospitalier Universitaire de Quebec and later successfully commissioned and started up the system in the first quarter FY 2008. Late in the year the Corporation received a purchase order valued at approximately \$250,000 to install its newly acquired energy saving, GEM® condensate return technology at a Global 500 company's facility in the U.S.

In addition the Corporation successfully diversified its business development model using its THERMAL-AUD program to initiate direct sales of proven FLU-ACE® and DRY-REX® solutions to established Fortune 500 customers, while continuing to develop new non-exclusive strategic alliances under a new more cooperative joint venture alliance model.

During FY 2007, the Corporation cooperated with JCLP to develop and propose many industrial and institutional Standard and Hybrid FLU-ACE® Energy Recovery Solutions to establish a growing multimillion dollar potential sales pipeline in Canada and the US. While the Corporation was successful in generating only \$821,024 in sales during FY 2007, it secured approximately \$3.9 million with approximately \$3 million in carry-forward revenues. However, the potential sales pipeline of qualified bids significantly increased to an amount in excess of \$70,000,000 and these will carry-over to FY 2008.

The Thermal Energy and JCLP cooperative mission statement can be summarized as follows: to increase sales through existing (JCLP) customer relationships by targeting energy solutions sales opportunities which will result in a faster sales cycle for both companies, while targeting niche industrial and commercial market sectors where Thermal Energy solutions provides a strong competitive advantage.

During FY 2007 the Corporation remained committed to the future product development and commercialization of the patented THERMALONOX™ technology with the filing of a patent on new technology at the core of its THERMALONOX™ solution. Over the past year, the Corporation's chief scientist, Dr. Raymond Belanger, has conducted numerous laboratory testing of ozone generation, which is fundamental to the chemical reaction required to remove NOx from flue gas streams and one of several components required for a complete emission reduction solution. Additionally, the Corporation continued to evaluate potential partners in the medium and large electric utility market who could sponsor a large scale demonstration of the technology now that it has successfully completed its laboratory testing. Finally it reached an agreement with the South China University of Technology (SCUT), with Chinese government backing, to jointly research and develop industrial applications for the Company's THERMALONOX™ on a coal-fired power plant slip stream in Guangdong province which has been indentified by SCUT as a suitable test site.

During the early part of FY 2007 the Corporation expanded its suite of energy savings solutions by acquiring the award-winning, patented DRY-REX™ bioenergy technology from Mabarex Inc., of Montreal (www.mabarex.com). With this agreement, the Corporation took immediate ownership of the exclusive worldwide license to the DRY-REX™ technology and the transfer of all intellectual property (patent) rights on an earn-out basis over five years.

The total value of the acquisition was \$3.25 million. This included the issuance of 500,000 common shares of the Corporation at a deemed price of \$0.16 per share. The remainder of the acquisition price is to be retired through royalty payments on the Corporation's sales of DRY-REX™ solutions.

The Corporation was successful in financing its working capital requirements to support its business development efforts, by raising capital through the completion of five (5) non-brokered private placements. The first closed on December 29, 2006 for gross proceeds of \$778,638. The financing consisted of an issuance of 1,862,162 Units at \$0.16 per unit with each unit comprising one common share and one non-transferable share purchase warrant entitling the holder to acquire one additional common share at any time within one year of issuance at a price of \$0.30

per share. It also consisted of an issuance of 3,004,334 flow-through shares at a deemed price of \$0.16 per share. The second placement closed on March 31, 2007 and consisted in the issuance of 1,350,000 common shares at a deemed price of \$0.14 per share for gross proceeds of \$189,000. The third private placement closed on April 27, 2007 with the issuance of 4,100,000 shares of the Corporation at the deemed price of \$0.16 per share with gross proceeds of \$656,000. The fourth private placement with gross proceeds of \$1,000,000 closed on May 16, 2007 with the issuance of 4,166,666 Units, each unit comprising one common share of the Corporation at the deemed price of \$0.24 per share and one warrant to purchase a common share at the deemed price of \$0.40 per share for a period of up to 2 years. And finally the fifth private placement with gross proceeds of \$312,500 closed on May 25, 2007 with the issuance of 1,250,000 Units, each unit comprising one common share of the Corporation at the deemed price of \$0.25 per share and one warrant to purchase a common share at the deemed price of \$0.40 per share for a period of up to 2 years.

The Corporation incurred a net loss during the year of \$2,443,265 compared to \$2,216,733 during the previous year and has an accumulated deficit at year-end of \$18,714,074. The Company's ability to continue as a going concern has improved by obtaining an appropriate level of financing and will continue to improve by achieving or exceeding targeted gross margins as was the case in the recently completed work at Minas Basin Pulp and Power Co. In addition the Company anticipates further funds will become available in the approximate amount of \$3,000,000 from the exercising of options and warrants later in the second half of FY 2008 and early part of FY 2009. Together this will satisfy the planned expansion of its R&D work on its new THERMALONOX™ technology solution and significantly expand sales and marketing throughout North America and China.

Revenues and Gross Profit

Revenues were \$821,024 in FY 2007 compared to \$2,845,341 in FY 2006. Revenues decreased significantly in FY 2007 compared to FY 2006 due primarily to a three to four month delay encountered in signing its first two US contracts. As a result approximately 50% of \$1,000,000 of revenue received but yet unearned has been deferred to the first quarter of FY 2008.

The gross loss of \$53,491 in FY 2007 decreased from a gross loss of \$126,815 in FY 2006. These results expressed as a percentage of sales were (6.51%) in FY 2007 compared with (4.45%) in FY 2006. The lower gross loss in FY 2007 compared to the gross loss in FY 2006 was due to a combination of reduced cost over-runs and warranty related costs incurred compared to the previous year's costs incurred to remedy the design deficiencies at the Valley Regional Hospital and at the Stratford General Hospital as well as the cost over-runs at the Camco project.

Expenses

Administration expenses in FY 2007 were \$880,331 compared with \$841,737 in FY 2006. The increase in costs was due to additional services required to meet the demands of the increased business activity of the Company.

Selling, marketing and business development expenses were \$1,266,359 in FY 2007 which increased significantly compared to \$883,461 in FY 2006 due mainly to increases in salaries of \$78,980, commissions of \$83,820, stock-based compensation of \$150,904 and travel, living, auto expenses of \$57,504 for a total of \$371,208.

Legal expenses in FY 2007 were \$18,850, a significant decrease compared to the amount of \$155,950 incurred in FY 2006. The decrease arose from the relative inactivity, changes and prosecutorial delays by the past President and CEO in his litigation against the Company.

Audit expenses in FY 2007 were \$77,500 compared to \$68,797 in FY 2006. The increase in fees arose due to increase costs of providing assurances

Financial Information (Cont'd)

services, a cost of living increase and reflects the complex transactions with shareholders and employees, including the use of non-monetary compensation such as stock options and other financial instruments.

Insurance expenses decreased slightly to \$78,498 in FY 2007 compared with \$82,166 in FY 2006 due to a reduction in premiums.

Patent and trademark maintenance costs were \$23,715 in FY 2007 compared to \$16,059 in FY 2006 with respect to countries where patents have been granted. Patent and trademark maintenance costs are expensed as incurred. The increase in costs year over year was due the Company's filing of the final patent application of its THERMALONox™ technology in the last quarter of FY 2007.

Research and Development costs increased slightly in FY 2007 to \$99,875 compared to \$89,880 in FY 2006 and resulted from increased labour charges.

Amortization of property, plant and equipment was \$24,828 in FY 2007 compared to \$18,518 in FY 2006. The increased costs were due primarily to the amortization of new equipment associated with the R&D laboratory in the Company's offices in Chilliwack, B.C.

Other Revenues

Other revenue was \$5,240 in FY 2007 resulting from a gain on the extinguishment of a liability and compared with \$290,214 in FY 2006 which was due primarily to an adjustment to the past President's account.

Other Costs

Other costs were \$36,001 in FY 2007 compared to \$310,096 in FY 2006. These were the final additional costs incurred to remedy a design deficiency for the Valley Regional Hospital project and were summarily classified to monitor against a potential insurance recovery claim.

Net Loss

Net Loss was \$2,443,265 in FY 2007 compared to a net loss of \$2,216,733 in FY 2006. Contributing factors resulting in the greater loss in 2007 were the cost over-runs at the Centre Hospitalier Universitaire de Quebec and Minas Basin and warranty related costs at Minas Basin and Camco, increased selling, marketing and business development costs, delays in the award of two U.S. contracts which deferred the recognition of \$1,000,000 of revenue into FY 2008 and insufficient sales volume to cover the current level of fixed costs of the Company required to produce a net profit. Management continues to work hard to control overhead costs but its main focus at the present time is a dedicated effort to secure much improved sales results.

Liquidity

The working capital of \$559,350 at the end of FY 2007 increased significantly compared to the working capital deficiency of \$414,337 at the end of FY 2006. Current assets increased by \$1,247,160 to \$2,063,551. The major changes were a decrease in accounts receivable of \$197,914 more than offset by an increase of \$490,077 in cash and \$1,020,880 in short term investments. Current liabilities increased by \$273,473 to \$1,504,201. The changes were a decrease in accounts payable of \$618,881 and accrued liabilities of \$8,646 and offset by an increase in deferred revenue of \$901,000. Other cash requirements in FY 2007 were met by the issue of common shares with a value of \$2,840,846 primarily from private placements. This was in excess of current requirements and \$1,020,880 was invested in short term securities. Cash requirements continued to be adversely affected by insufficient sales volume to cover the current level of fixed and variable costs.

Management continues to recognize the requirement to further improve liquidity in order to continue as a going concern, and as a result is aggressively working to increase sales and is continuing to develop new cooper-

ative business relationships and exclusive sales distributorships in different, but complementary, product lines. In addition, the Company has completed five (5) non-brokered private placements in the third and fourth quarters of FY 2007 with gross proceeds of \$2,936,138. All this had been preceded with the completion of a non-brokered private placement in the fourth quarter of FY 2006 with gross proceeds of \$734,900.

Additionally the Company is actively exploring opportunities to further structure a multi-million dollar financing of its new Business Plan. The proceeds raised would be used for expanded sales and marketing efforts, strategic acquisitions and R&D activities with THERMALONox™.

Related Party Transactions

In FY 2007 Directors were paid fees for services of \$18,750, officers were paid \$192,000. Additionally, the Chairman was paid a fee of \$18,000 for consulting services.

In addition, 3,233,000 common share options issued to Directors became exercisable, 1,434,000 common share options issued to officers became exercisable.

Loans in the amount of \$54,469 in the form of advances against pending sales commissions (\$46,969 from the President and \$7,500 from an Officer) were outstanding at May 31, 2007.

Supplementary Financial Information

The following table shows selected consolidated financial data for the three most recently completed financial years.

	2005 \$	2006 \$	2007 \$
Sales	668,204	2,845,341	821,024
Net loss	(1,421,589)	(2,216,733)	(2,443,265)
Net loss per share - basic and diluted	(0.026)	(0.033)	(0.031)
Total assets	1,314,129	931,430	2,131,163

Trend Analysis:

The earned revenue from sales in FY 2005, FY 2006 and FY 2007 are inconsistent in magnitude. The increased sales funnel and resultant earned revenue from sales in FY 2006 increased due to the efforts of a new and more vigorous sales team which accompanied the newly placed management team in the Company. In FY 2007, while secured sales increased to approximately \$3.9 million year-over-year because of long delays in the awarding of two contracts the earned revenue from sales fell significantly.

The net losses in FY 2006 increased from those reported in FY 2005 due to a decrease in gross profits from 27.34% in FY 2005 to (4.45%) in FY 2006 due to the extra cost over-runs of the Camco project, the costs to remedy design flaws at the Valley Regional Hospital and Stratford General Hospital projects and the litigation costs to defend against the past President.

The net losses further increased in FY 2007 due to a significant drop in earned revenue from sales as a result of a three to four month delay encountered in signing its first two U.S. contracts.

The variations in assets from FY 2005 through to FY 2007 were affected primarily by an investment of \$800,263 in short term investments in FY 2005 following the closing of a private placement in the amount of

Financial Information (Cont'd)

\$1,100,100 late in the fourth quarter of FY 2005. This investment was drawn down in FY 2006 to meet cash requirements. A further closing of a private placement in the amount of \$734,900 which was drawn down in FY 2006 was followed with five private placements in the amount of \$2,936,138 in FY 2007.

Disclaimer

The information provided in this document is not intended to be a comprehensive review of all matters concerning the Company. It should be read in conjunction with all other disclosure documents provided. No securities commission or regulatory authority has reviewed the accuracy or adequacy of the information presented herein and, as noted in the financial statements ended May 31, 2007, these statements were subject to an audit by our independent public accountants.

Business Risks

Management is confident about our long-term prospects, but we recognize that we are exposed to a number of risks in the normal course of business that could negatively impact the financial condition of the Company.

The Company is engaged in the development, engineering and supply of pollution control and heat recovery systems. Operational risks of the company include the ability to continue to secure and implement multiple sales contracts each year for standard, hybrid, and multi-air pollutant FLU-ACE® technology solutions. In addition, the Company has not yet been able to finance and complete the development and commercialization of its patented THERMALONOX™ technology. The THERMALONOX™ patented technology is yet to be tested and the Company will be seeking potential partners and investors to sponsor the costs associated with the implementation of a THERMALONOX™ demonstration pilot project. This will occur upon the successful completion of new, ongoing and promising laboratory testing. Cost Effective Energy Conservation and Environmental Compliance Solutions sales through the JCLP cooperation has not limited the size of the market but has increased the market potential.

Financial risks and uncertainties of the Corporation include:

- The Company's history of operating losses and uncertainty of future profitability;
- The ability to continue to grow quicker sales through the existing JCLP cooperation agreement;
- The ability to grow sales through the establishment of new cooperative partnerships and strategic alliances;
- The ability to grow sales through the licensing of the corporation's technologies;
- The ability to secure and maintain the required outside working capital financing;
- The ability to achieve profitable operations through increased sales,
- Reliance on third party collaborations and license arrangements;
- Reliance on proprietary technology;
- Competition in the energy conservation and environmental compliance solutions;
- Product liability claims and insurance;
- Reliance on key personnel and;
- The ongoing litigation with its former President & CEO.

Management's addressing of the risks:

The management of the Company realizes that the increased operating losses in FY 2007, while displaying a consistent pattern of losses as in previous years were primarily due to the unexpected delays in the awarding of two projects and their revenue streams to offset some of the Company's fixed and variable costs. In short, while the sales funnel increased significantly year-over-year it demonstrates the Company's inability to close the "deal" in a timely fashion and the need to improve its efforts to shorten the sales cycle.

With the addition of a new Vice President of Sales in Q1 FY 2008 to fully focus on sales and marketing, the Company believes that it will be more

productive in future quarters in its pursuit and closing of sales opportunities.

Management believes that it can continue to grow sales through the existing JCLP cooperation agreement as evidenced by the two recently awarded contracts to perform work for its clients in the U.S. In addition there are numerous projects that it is presently jointly pursuing with JCLP both in Canada and the U.S and abroad.

In addition management has signed an agreement with the South China University of Technology (SCUT), with Chinese government backing, to jointly research and develop industrial applications for the Company's THERMALONOX™ nitrogen oxides (NOx) removal technology. The R&D program envisions demonstrating THERMALONOX™ on a coal-fired power plant slip stream in Guangdong province which has been tentatively identified by SCUT as a suitable test site. The Company believes that this cooperative partnership could help to grow its sales and possibly lead to licensing agreements after successful trials of the Corporation's technologies.

The current management has demonstrated that it can secure outside working capital when required, as evidenced by the successful closings of its five Private Placements with gross proceeds of \$2,936,138 in the second half of FY 2007 and which had been preceded with the completion of a non-brokered private placement in the fourth quarter of FY 2006 with gross proceeds of \$734,900.

Management believes that by maintaining its small core of personnel and high margins on more secured contracts that it will achieve profitable operations. Small incremental staffing increases will be introduced from time to time depending on the demand arising from increased sales volumes.

Management has expanded its suite of energy savings solutions by acquiring the award-winning, patented DRY-REX™ bioenergy technology from Mabarex Inc., of Montreal (www.mabarex.com). With this agreement, the Company took immediate ownership of the exclusive worldwide license to the DRY-REX™ technology and the transfer of all intellectual property (patent) rights on an earn-out basis over five years. This adds to the Company's previous acquisition of new licenses and distributorship rights to GEM®, a leading European (Great Britain) line of industrial/commercial steam traps and THERMALOZOMAX™, an ozone generation technology. In Q3 FY 2007 the Company received a major order valued at approximately \$250,000 under its exclusive license for the GEM® Condensate Return System from A Global 500 company at a U.S. location.

The Company is protecting its proprietary technology through registered trademarks and confidentiality agreements. It has recently filed a new provisional patent for THERMALONOX™, a technology which is currently undergoing laboratory testing.

Management believes that competition against its core technologies of FLU-ACE™ and DRY-REX® is limited at this time and in any event believes that the market place is sufficiently large enough to permit stronger competition in the future and firmly believes that the Company is in a better position now with a significantly enhanced arsenal of building blocks to draw on in presenting a more comprehensive solution to customers.

Highlights

On July 10, 2006 the Company announced that it had significantly expanded its sales capacity with the appointments of six experienced representatives from North to South America.

On September 7, 2006 the Company announced that together with Johnson Controls it had commenced the initial phase of a heat recovery/energy cost reduction project in the US for one of the world's largest producers of consumer foods.

On September 11, 2006 the Company announced that it had acquired the sole and exclusive worldwide license to the award winning Dry-Rex™

Financial Information (Cont'd)

system from Mabarex Inc., of Montreal, Quebec. The terms of the deal also include the transfer of all intellectual property rights to the patented Dry-Rex™ technology on an earn-out basis over five years. The value of the acquisition over time is \$3,250,000 and includes an initial sum of \$80,000 in the form of an issuance of 500,000 common shares of the Company at a deemed price of \$0.16 per share. Dry-Rex™ uses waste heat to turn bark, sludge and other biomass into high-efficiency bio-energy fuel for pulp mills and other industrial applications.

On December 1, 2006 the Company announced that it would be implementing a heat recovery/energy cost reduction project in the U.S. in the food and beverage sector for an estimated value in excess of \$1.4 million.

On December 29, 2006 the Company announced that it had closed a non-brokered private placement with gross proceeds of \$778,638. The financing consisted of the issuance of 4,866,496 share units at a deemed price of \$0.16 per share. Insiders participating in the private placement subscribed for a total of 874,334 share units resulting in proceeds of \$139,893.

On December 29, 2006 the Company announced that it issued 3,500,000 stock options to certain directors, officers, employees and consultants to acquire common shares of the Company at a deemed price of \$0.16 per share and up to three years from the date of grant. 2,500,000 of these options will be earned on a performance basis.

On January 31, 2007 the Company announced that it had received a \$2.5 million-plus energy efficiency contract at a major industrial facility in the U.S. making this the second commercial contract in the U.S. market and the first to use both the Company's FLU-ACE® waste heat recovery solutions and its new state-of-the-art GEM® Condensate Return System.

On March 1, 2007 the Company announced that it had received a major order valued at approximately \$250,000 under its exclusive license for the GEM® Condensate Return System FROM A Global 500 company at a U.S. location.

On March 31, 2007 the Company announced that it had closed a non-brokered private placement with gross proceeds of \$189,000. The financing consisted of an issuance of 1,350,000 common shares at the deemed price of \$0.14 per share.

On April 3, 2007 the Company announced that it had completed filing the final patent applications of technology at the core of its THERMALONOX™ nitrogen oxides (NOx) reduction solution. A patent application was filed with the United States and Trademark Office and another application was filed with the Canadian Receiving Office for the Patent Cooperation Treaty to simultaneously start patenting the new technology in 137 countries across Europe, South America and China – the world's largest coal-fired power market. The laboratory tests repeatedly demonstrated consistent results of more than 98% removal of nitrogen oxides from simulated flue gas streams.

On April 10, 2007 the Company announced that it had signed an agreement with the South China University of Technology (SCUT), with Chinese government backing, to jointly research and develop industrial applications for the Company's THERMALONOX™ nitrogen oxides (NOx) removal technology. The R&D program envisions demonstrating THERMALONOX™ on a coal-fired power plant slip stream in Guangdong province which has been tentatively identified by SCUT as a suitable test site.

On April 27, 2007 the Company announced that it had closed a non-brokered private placement with gross proceeds of \$656,000. The financing consisted of an issuance of 4,100,000 common shares at the deemed price of \$0.16 per share. Thirty non-insiders participated in this financing.

On May 16, 2007 the Company announced that it had completed an institutional private placement with a syndicate of investment firms including Whitebox Advisors LLC, an SEC-registered investment advisor with

over \$2 billion in assets, headquartered in Minneapolis, and a Toronto investment firm. The Company received gross proceeds of \$1 million from the issuance of 4,166,666 units, each comprising one common share of the Company at a deemed price of \$0.24 per share and one warrant to purchase a common share of the Company at a deemed price of \$0.40 per share for a period of up to two years. Under the terms of the private placement, the syndicate participants had an option to increase the size of the placement by up to 30% at a 10% discount to market price for a period of 60 days from the date of closing.

On May 25, 2007 the Company announced that Whitebox Advisors LLC had exercised its option from the previously announced institutional financing to increase the total gross proceeds from the private placements to \$1,312,500. The Company issued an additional 1,250,000 units each comprising one common share of the Company at a deemed price of \$0.25 per share and one warrant to purchase an additional share of the Company at an exercise price of \$0.40 per share for a period of up to two years.

On May 31, 2007 the Company announced that William M. Crossland had been appointed to the Board of Directors. Mr. Crossland spent over 18 years with the National Bank of Canada's Corporate and Investment Banking Group most recently as Managing Director, Investment Banking.

Outlook

Statements in this discussion are forward-looking and as such, are subject to various risks and uncertainties concerning a variety of factors. Such information contained herein represents management's best judgment as of the date hereof based on the information currently available.

During Q1 of FY 2008, the Corporation has been focused equally on direct sales and cooperative sales development activities in Canada, USA and China. The majority of the Corporations' sales, marketing, and business development resources have been utilized equally in support of the Johnson Controls' cooperative energy solutions sales development activities; as well as in support of some direct sales development activities through independent sales agents in Michigan, Maine, Ontario, Quebec, British Columbia, Alberta, Mexico and China to selected industrial process industrial facilities where existing customer relationships are already in place. This has led to the submission of several proposals currently including the Company's THERMAL-AUD™ program with clients for approval and several invitations to other client sites for submission of other proposals.

The Corporation anticipates that these initiatives will not only produce increased sales revenues and gross profit in the second quarter FY 2008 (ending November 30, 2007) but become a harbinger for continued improvement to the Consolidated Balance Sheet that began in the fourth quarter of FY 2007.

On June 15, 2007 the Company announced the appointment of Anthony J. Pugliese as Vice President, Sales. Mr. Pugliese came from Direct Energy Business Services where he was Manager, Business Development, Health Care Sector, responsible for leading the development and implementation of market strategies in the Canadian healthcare and public sector markets. Prior to his tenure at Direct Energy, Mr. Pugliese was Account Manager, Healthcare Solutions with Johnson Controls, Inc. in eastern Canada.

On June 19, 2007 the Company announced that it had signed a Memorandum of Understanding to develop a joint venture with the Jiangnan Boilers and Pressure Vessels Company, Ltd. (JBPV), to deploy the Company's energy recovery solutions in key Chinese markets. JBPV with revenues of \$90 million annually, serves the chemical fertilizer, medical, oil and chemical industries in China and works with a number of international companies such as York International, BASF, SECCO, Inc., and SPX Corp.

On June 21, 2007 the Company announced that it had formalized a research and development agreement with South China University of Technology (SCUT) focused on the commercialization of the Company's THERMALONOX™ nitrogen oxides (NOx) removal technology for China's coal-fired power market. The formal agreement opened the door for the

Financial Information (Cont'd)

initial Chinese investment in the research of \$1 million RMB (\$140,000) by the Guangzhou Municipal Science and Technology Bureau for SCUT's project resources commitment to the Company. The funding is to be in place within 90 days.

On June 26, 2007 the Company announced that it had signed a letter of intent to enter its first long-term energy services agreement with one of the largest North American forest products pulp and paper process, which has a wide-spread, repeatable, application for the industry. The agreement envisages an initial five-year solution to provide the customer with approximately \$2.5 M in positive cash flow and to cut greenhouse gas emissions by 50,000 tons of CO₂.

On June 28, 2007 the Company announced that it reached an agreement with Gardner Energy Management of Bristol, UK, to market its GEM® Condensate Return System in China. China represents a multi billion dollar market for condensate return systems and is the fastest growing steam systems market in the world.

On July 11, 2007 the Company announced that one of the largest pulp and paper manufacturers in China was commencing a trial installation of the GEM® Condensate Return System.

On August 7, 2007 the Company announced that it had received its first order in China for GEM® Steam Traps from Lee and Man Paper Manufacturing Co. to be installed on one of its paper machines in one of their massive plants that produces over 1.5 million tons of containerboard annually. Lee and Man will monitor the results as a basis for considering other conversions of their large condensate systems at their various plants.

On August 9, 2007 the Company announced that it had broken into Alberta's oil, gas and petrochemical sector with a contract from an Edmonton-area petrochemical manufacturer, to begin retrofitting approximately one-third of its mid-size facility with GEM® steam traps.

On August 15, 2007 the Company announced the establishment of ForEverGreen Energy Inc., a wholly-owned green energy services subsidiary. The subsidiary will own and operate the Company's assets to be used under the Thermal AUD™ (Alternate Utility Delivery) program, that will allow the Company's customers to benefit from energy savings without capital investments. The Company will derive its revenues from the sale of assets to, and investments in the subsidiary.

On August 27, 2007 the Company announced that its wholly-owned energy services subsidiary, ForEverGreen Energy Inc. (FEI) signed an agreement for up to \$3.75M with Fraser Paper Inc. to recover waste heat at its Thurso Mill. The green power agreement using Thermal AUD's (Alternative Utility Delivery) Program is for a term of six years. The Company will enter into a contract with FEI to supply, install and performance manage its FLU-ACE® system at the Thurso pulp mill.

On September 18, 2007 announced that it had signed a Letter of Intent with an Eastern Canada pulp and paper mill for a DRY-REX® biomass drying system to dry the mill's biomass waste stream including paper sludge for use as biofuel. The feasibility study will be completed in December, 2007 and if accepted by the mill, would lead to a contract to implement the DRY-REX® system using the Thermal-AUD™ program through Thermal's energy services subsidiary (FEI).

Financial Information (Cont'd)

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL REPORTING

The consolidated financial statements of Thermal Energy International Inc. and all the information in this annual financial report have been prepared by management, which is solely responsible for the integrity and fairness of the data presented, including the many amounts, which due to necessity, are based on estimates and judgments. The accounting policies followed in the preparation of these consolidated financial statements conform with Canadian generally accepted accounting principles. When alternative accounting methods exist, management has chosen those that it deems most appropriate in the circumstances. Financial information presented throughout this report is consistent with that in the consolidated financial statements.

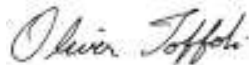
Thermal Energy International Inc. maintains systems of internal accounting and administrative controls to provide reasonable assurance that the financial information is relevant, reliable and accurate and that transactions are authorized, assets are safeguarded and proper records are maintained.

The Board of Directors is responsible for ensuring that management fulfills its responsibility principally through its Audit Committee.

Thermal Energy International Inc.'s external auditors, Raymond Chabot Grant Thornton LLP ("RCGT"), have conducted an independent audit of the consolidated financial statements in accordance with Canadian generally accepted auditing standards, performing such tests and other procedures as they consider necessary to express an audit opinion. The external auditors have full and unrestricted access to the Audit Committee to discuss their audit and related findings.



Tim Angus
President & CEO



Oliver Toffoli
General Manager & CFO

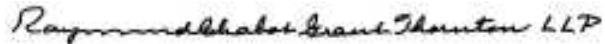
AUDITORS' REPORT

To the Shareholders of Thermal Energy International Inc.

We have audited the consolidated balance sheets of Thermal Energy International Inc. as at May 31, 2007 and 2006 and the consolidated statements of operations and deficit and cash flows for the years then ended. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at May 31, 2007 and 2006 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.



Chartered Accountants,
Licensed Public Accountants

Ottawa, Canada
September 18, 2007

Financial Information (Cont'd)

Thermal Energy International Inc.

Incorporated under the Ontario Business Corporations Act

CONSOLIDATED BALANCE SHEETS

As at May 31

	2007	2006
	\$	\$
ASSETS		
Current assets		
Cash	549,196	59,119
Short term investments (note 4)	1,020,880	-
Accounts receivable (note 5)	428,581	626,495
Contracts in progress	4,000	89,000
Prepays and other assets	60,894	41,777
	2,063,551	816,391
Loans receivable (note 6)	-	55,500
Property, plant and equipment (note 7)	67,612	59,539
	2,131,163	931,430
LIABILITIES, CAPITAL STOCK, CONTRIBUTED SURPLUS AND DEFICIT		
Current liabilities		
Accounts payable	328,182	947,063
Accrued liabilities	158,082	166,728
Deferred revenue	1,000,000	99,000
Due to past President (note 8)	17,937	17,937
	1,504,201	1,230,728
Capital stock, contributed surplus and deficit		
Capital stock (note 9)	17,459,549	14,462,279
Contributed surplus (note 9)	1,881,487	1,509,232
Deficit	(18,714,074)	(16,270,809)
	626,962	(299,298)
	2,131,163	931,430

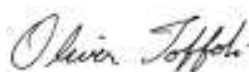
Contingency (note 17)

The accompanying notes are an integral part of these consolidated financial statements

On behalf of the Board



Tim Angus
President & CEO



Oliver Toffoli
General Manager & CFO

Financial Information (Cont'd)

CONSOLIDATED STATEMENT OF CASH FLOWS

Year ended May 31

	2007	2006
	\$	\$
OPERATING ACTIVITIES		
Net loss for the year	(2,443,265)	(2,216,733)
Add items not involving cash:		
Stock-based compensation charge	377,755	431,827
Amortization of property, plant and equipment	24,828	18,518
Future income taxes	(195,000)	(78,400)
Write-off of past President loan to acquire shares	151,500	-
Non-monetary compensation charge	13,031	-
Debt settlement with past President	-	(232,305)
Changes in non-cash operating working capital		
Accounts receivable	197,914	(395,236)
Contracts in progress	85,000	(24,000)
Prepays and other assets	(19,117)	(34,166)
Accounts payable	(437,488)	714,997
Accrued liabilities	(8,646)	(151,722)
Deferred revenue	901,000	(375,000)
Due to the past President	-	(50,730)
Net cash used in operating activities	(1,352,488)	(2,392,950)
INVESTING ACTIVITIES		
(Acquisition) disposal of short term investments	(1,020,880)	800,263
Additions to property, plant and equipment	(32,901)	(42,279)
(Increase) decrease in loan receivable	55,500	(55,500)
Net cash used in investing activities	(998,281)	702,484
FINANCING ACTIVITIES		
Common shares issued (note 9)	2,840,846	1,575,367
Net cash provided by financing activities	2,840,846	1,575,367
Increase (decrease) in cash for the year	490,077	(115,099)
Cash, beginning of year	59,119	174,218
Cash, end of year	549,196	59,119
Interest paid	3,242	1,928
Tax impact of renounced expenditures	195,000	78,400
Shareholder loans to acquire shares	7,500	119,305

The accompanying notes are an integral part of these consolidated financial statements.

Financial Information (Cont'd)

CONSOLIDATED OPERATIONS AND DEFICIT

Year ended May 31

	2007	2006
	\$	\$
REVENUE		
Sales	821,024	2,845,341
Cost of sales	874,515	2,972,156
Gross loss	(53,491)	(126,815)
Expenses		
Administration	880,331	841,737
Selling, marketing and business development	1,266,359	883,461
Legal fees	18,850	155,950
Audit fees	77,500	68,797
Insurance	78,498	82,166
Amortization of property, plant and equipment	24,828	18,518
Patent and trademark maintenance	23,715	16,059
Research and development	99,875	89,880
Interest and bank charges	16,832	6,749
Foreign exchange loss (gain)	67,787	(3,851)
	2,554,575	2,159,466
	(2,608,066)	(2,286,281)
Other revenue (note 13)	5,240	290,214
Interest revenue	562	11,030
Other costs (note 14)	(36,001)	(310,096)
Loss before income taxes	(2,638,265)	(2,295,133)
Future income tax recovery (note 12)	195,000	78,400
Net loss	(2,443,265)	(2,216,733)
Deficit, beginning of year	(16,270,809)	14,054,076
Deficit, end of year	(18,714,074)	(16,270,809)
Net loss per share - basic and diluted	(0.031)	(0.033)
Weighted average number of common shares	78,443,983	67,418,141

The accompanying notes are an integral part of these consolidated financial statements

Financial Information (Cont'd)

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

1 GOVERNING STATUTES AND NATURE OF OPERATIONS

The Company was incorporated under the Ontario Business Corporations Act on May 22, 1991 and is primarily engaged in the development, engineering and supply of pollution control and heat recovery systems.

2 GOING CONCERN

The Company incurred losses from operations in the current and prior year.

The Company's ability to meet its obligations as they fall due is dependent upon any combination of the following: the continued financial support of its shareholders, its ability to arrange long-term financing and its ability to generate sufficient cash from operations.

The financial statements have been prepared on the going concern basis, which assumes the realization of assets and the satisfaction of liabilities in the normal course of business. These financial statements do not include any adjustments to the carrying value or classification of assets and liabilities, nor to the results of operations, should the Company not continue to operate as a going concern.

Management is of the opinion that sufficient funds will be available from operations, external financing, and the continued financial support of its principal shareholders to meet the Company's liabilities and commitments as they become due.

3 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies are as follows:

Basis of consolidation

The consolidated financial statements of the Company include the accounts of its wholly owned subsidiary, 2003356 Ontario Inc. and Thermal Energy International Corporation incorporated under the laws of the State of Delaware in the United States of America.

Use of estimates

Since a precise determination of many assets and liabilities is dependent upon future events, the preparation of financial statements for a period in conformity with Canadian generally accepted accounting principles necessarily involves the use of estimates and approximations which have been made by management using careful judgment. Actual results could differ from these estimates.

Revenue recognition

Contract income is recorded under the percentage-of-completion method. Under this method, contract income and profit are recognized proportionately with the degree of completion of work. Degree of completion is determined using the cost-to-cost method, which consists in comparing the costs incurred at the date of the financial statements with the last estimate of the total cost of work to be performed. Contracts in progress are valued considering labour, material and some overhead costs, which include estimated profits. Losses are recognized when total cost estimates indicate a loss. Amounts billed or payments received but not yet earned are deferred until the revenue is earned.

Cash and cash equivalents

All highly liquid investments with original maturities of three months or less are classified as cash equivalents. Cash and cash equivalents are recorded at cost which approximates fair value.

Short term investments

The Company invests cash surplus to current requirements in money market funds. They are recorded at the lower of cost or market.

Amortization

Property, plant and equipment are recorded at cost. Amortization is computed using the following annual rates and methods:

Furniture and fixtures	20% declining-balance
Laboratory equipment	20% declining balance
Computers	3 years straight-line
Software	50% declining-balance
Leasehold improvements	3 years straight-line

Loss per share

The basic loss per share is calculated on the basis of net loss divided by the weighted average number of common shares outstanding during the year. The diluted per share amount is calculated giving effect to the potential dilution that would occur if securities or other contracts to issue common shares were exercised or converted to common shares. The treasury stock method is used to determine the dilutive effect of stock options. The treasury stock method assumes that proceeds received from the exercise of the in-the-money stock options are used to repurchase common shares at the prevailing market rate. The diluted loss per share is equal to the basic loss per share because the effect of dilutive stock options described in Note 11 is antidilutive.

Income taxes

The liability method is used to account for income taxes. Future tax assets and liabilities are recognized for tax consequences of temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities. Future tax assets and liabilities are measured using substantively enacted tax rates in effect for the year in which the differences are expected to be recovered or settled. A valuation allowance is established to reduce the future tax asset if it is not "more likely than not" that the related tax benefits will be realized in the future.

Research and development costs and government assistance

The Company carries on various research and development programs, and from time to time these are funded by the Government of Canada. Funding received is accounted for using the cost reduction approach and is netted against research or development costs. Research costs are expensed as incurred. Development costs are charged to expense as incurred unless they meet generally accepted accounting criteria for deferral and amortization. No costs have been deferred to date.

Foreign currency translation

All monetary assets and liabilities denominated in foreign currency are translated into Canadian dollars at the exchange rate in effect at the balance sheet date, whereas other assets and liabilities are translated at exchange rates in effect at transaction dates. Revenues and expenses in foreign currency are translated at the average exchange rate in effect during the period. Gains and losses are included in the earnings for the year.

Investment tax credits

Investment tax credits are accounted for under the cost reduction method whereby they are netted against the cost of the property, plant and equipment to which they relate. Investment tax credits are recorded when the Company has incurred qualifying expenditures and there is reasonable assurance the tax credit will be realized.

Financial Information (Cont'd)

Stock-based compensation

The Company accounts for its grants under stock-based compensation plans using the fair value method and compensation expense is recognized in the period in which the options vest. When holders exercise their options, any consideration received and any contributed surplus related to these options is credited to capital stock.

Share purchase loans are accounted for in accordance with EIC Abstract 132 "Share Purchase Financing". These loans, which were extended to shareholders to purchase Class A common shares are considered to be stock options and are treated as stock-based compensation and recorded at their fair market value.

4 SHORT TERM INVESTMENTS

Short term investments consist of excess cash invested in money market funds.

5 ACCOUNTS RECEIVABLE

	2007 \$	2006 \$
Trade	377,124	517,914
Other	51,457	108,581
	428,581	626,495

At May 31, 2007, 94% (2006 - 90%) of trade receivables were from one customer.

6 LOANS RECEIVABLE

Loans receivable were \$Nil (2006 - \$55,500 and included an amount of \$37,000 from a director and \$18,500 from an officer). These loans bore no interest.

7 PROPERTY, PLANT AND EQUIPMENT

	2007		2006	
	Cost \$	Accumulated Amortization \$	Cost \$	Accumulated Amortization \$
Furniture and fixtures	81,671	62,597	81,671	58,176
Laboratory equipment	46,675	14,183	15,178	6,921
Computers	140,166	133,675	138,761	127,663
Software	12,081	12,081	12,081	12,081
Leasehold improvements	21,401	11,846	21,401	4,712
	301,994	234,382	269,092	209,553
Accumulated amortization	(234,382)		(209,553)	
Net book value	67,612		59,539	

8 RELATED PARTY TRANSACTIONS

Related party transactions, in the normal course of operations, are measured at exchange value which represents the amounts established and agreed upon by both parties.

	2007 \$	2006 \$
Transactions with and balances owing to/from directors		
Fees for services	36,750	18,000
Accounts receivable	-	1,635
Loans receivable	-	37,000
Accrued liabilities	18,750	6,750
Common shares issued	-	1,116,667
Flow-through shares issued	293,125	400,000

Directors share options outstanding at May 31

Issued	4,000,000	2,300,000
Exercisable	3,233,000	1,975,000

Transactions with and balances owing to/from officers

Fees for services	192,000	187,000
Accounts receivable	-	2,955
Loan receivable	7,500	18,500
Accrued liabilities	-	2,667
Common shares issued	125,000	733,000
Flow-through shares issued	143,081	107,422

Officers share options outstanding at May 31

Issued	1,993,000	1,043,000
Exercisable	1,434,000	880,500

Changes to the amounts due to the past President during the year were as follows:

	2007 \$	2006 \$
Balance due to the past President, beginning of year	17,937	300,972
Debt settlement (Note 13)	-	(232,305)
Payments made on behalf of past President	-	(730)
Cash payment to the past President	-	(50,000)
Balance due to the past President, end of year	17,937	17,937

Amounts due to the past President have no fixed repayment terms and are non-interest bearing.

Financial Information (Cont'd)

9 CAPITAL STOCK AND CONTRIBUTED SURPLUS

	2007		2006	
	# Shares	\$	# Shares	\$
Authorized				
Unlimited number of Class A common shares, no par value.				
Unlimited number of Series 1 preferred shares, voting only in the case of dissolution of the Company, redeemable at the option of the Company at \$0.01 per share and convertible to common shares on a 1 to 1 basis at the rate of 20% of the number originally issued per year.				
Class A Common shares issued				
Balance, beginning of year	74,570,256	14,733,084	63,198,899	12,776,987
Issued in settlement of liabilities	1,160,584	181,393	1,247,432	179,235
Issued for cash, net of flow through share tax benefit (i)	15,137,579	2,645,846	8,573,925	1,377,772
Issued as a result of the exercise of options	50,000	13,000	1,550,000	399,090
	90,918,419	17,573,323	74,570,256	14,733,084
Less: loans outstanding to assist shareholders in purchasing capital stock (ii)		(113,774)		(270,805)
Balance, end of year	90,918,419	17,459,549	74,570,256	14,462,279

(i) In February 2007, the Company renounced expenditures of \$540,000 (2006 \$216,973) from 3,484,334 (2006 2,012,432) flow-through common shares issued during the respective fiscal years. The resulting future income tax recovery of \$195,000 (2006 \$78,400) was charged against capital stock.

In fiscal 2007 and 2006 the Company completed private placements. The funds were raised by issuing Units that included one Class A common share and one non-transferable share purchase warrant.

(ii) A balance of \$46,969 is outstanding on a shareholder loan to the President to purchase shares in fiscal 2006. A loan to an officer of \$7,500 in fiscal 2007 and \$59,305 in fiscal 2006 to other shareholders to assist in the purchase of common shares was extended. These loans are due upon demand, bear no interest and have no fixed repayment terms. Stock-based compensation on these loans was estimated using the Black-Scholes option pricing model with a weighted average volatility assumption of 74% (114% fiscal 2006) and for both years an expected dividend rate of 0%, risk free interest rate of 3.85% and an expected life of one year.

During the year, the Company entered into a five year licensing and purchasing agreement with Mabarex for their Dry-Rex™ system. Under the terms of this agreement, the Company is required to issue 125,000 common shares at \$0.16 each to Mabarex for each of the first two contracts to use the Dry-Rex™ system.

In addition, the Company is committed to issue 1,101,217 options to directors and officers to purchase common shares at \$0.16 per share based on Company performance and which will expire on December 20, 2009.

(a) Activity in share purchase warrants was as follows:

	2007		2006	
	# Warrants	Weighted Average Exercise Price \$	# Warrants	Weighted Average Exercise Price \$
Balance, beginning of period	10,154,896	0.30	12,024,698	0.24
Issued	7,312,162	0.37	1,628,895	0.35
Exercised	-	-	(3,183,334)	0.14
Expired	(2,986,668)	0.25	(315,363)	0.14
Balance, end of period	14,480,390	0.35	10,154,896	0.30

(b) The following table summarizes the status of warrant outstanding at May 31, 2007:

Warrants Outstanding	Exercise Price \$	Expiry Date
3,333,666	0.35	To June 3, 2007
3,867,895	0.30	To April 22, 2008
760,000	0.30	To October 10, 2008
260,000	0.30	To November 2, 2008
236,912	0.30	To November 30, 2008
324,000	0.30	To December 6, 2008
281,250	0.30	To December 29, 2008
4,166,667	0.40	To May 23, 2009
1,250,000	0.40	To May 29, 2009
14,480,390		

Contributed surplus

	2007	2006
	\$	\$
Balance, beginning of year	1,509,232	1,237,995
Stock-based compensation	377,755	431,827
	1,886,987	1,669,822
Fair-value of options exercised and transferred to capital stock	5,500	160,590
Balance, end of year	1,881,487	1,509,232

10 COMMITMENTS

The Company is committed under the terms of operating leases for premises and office equipment contracts with various expiry dates in the following amounts:

	\$
2008	106,000
2009	34,300
2010	1,900
Total	142,200

11 SHARE OPTION PLAN

The Company established the Company's Share Option Plan applicable to Directors, Officers and full-time and part-time employees of the Company. In the plan, the aggregate number of options may not exceed 20% of the outstanding shares and the total number of shares

Financial Information (Cont'd)

to be optioned to any optionee may not exceed 5% of the number of issued and outstanding shares as at the option granting date. The options are granted with an exercise price equal to the market value of the common shares of the Company at the date of grant, less any permissible discounts, and may be exercised at any time after the vesting date, not to exceed five years from the date of granting. Vesting period for options granted is at the discretion of the Board of Directors. Options granted in fiscal 2007 and 2006 had vesting periods ranging from four to twelve months.

(a) Activity in stock options was as follows:

	2007		2006	
	# Options	Weighted Average \$	# Options	Weighted Average \$
Outstanding, beginning of year	4,718,714	0.17	7,043,714	0.16
Granted	4,475,000	0.17	850,000	0.23
Exercised	(50,000)	0.15	(1,550,000)	0.15
Cancelled	(250,000)	0.19	(975,000)	0.18
Expired	(525,714)	0.16	(650,000)	0.15
Outstanding, end of year	8,368,000	0.17	4,718,714	0.17
Number of options exercisable as at May 31	6,126,000		4,024,964	

Options exercised during the year were as follows:

	2007		2006	
	# shares	\$	# shares	\$
Employees	50,000	7,500	1,025,000	169,500
Directors	-	-	325,000	49,000
Consultants	-	-	200,000	20,000
	50,000	7,500	1,550,000	238,500

In 2007 and 2006, all options were exercised for cash.

(b) The following options are outstanding and/or exercisable at May 31, 2007:

Number of Options Outstanding	Number of Options Exercisable	Exercise Price Per Share \$	Expiry Date
193,000	193,000	0.10	January 12, 2008
250,000	250,000	0.20	January 24, 2008
1,000,000	1,000,000	0.10	February 1, 2008
500,000	500,000	0.12	February 1, 2008
150,000	150,000	0.24	March 1, 2008
900,000	900,000	0.22	April 29, 2008
250,000	250,000	0.24	May 19, 2008
100,000	100,000	0.24	June 2, 2008
150,000	150,000	0.24	June 10, 2008
150,000	150,000	0.24	August 15, 2008
250,000	250,000	0.26	September 9, 2008
350,000	350,000	0.18	September 7, 2009
3,500,000	1,883,000	0.16	December 20, 2009
625,000		0.20	March 15, 2010
8,368,000	6,126,000		

c) Stock-based compensation

The fair value of options granted was estimated using the Black-Scholes option pricing model with the following weighted average assumptions:

	2007	2006
Weighted average assumptions:		
Expected dividend	0.00%	0.00%
Expected volatility	90%	111%
Risk-free interest rate	3.85%	3.85%
Expected option life in years	2.4	2.4
Fair value	\$0.16	\$0.14

Stock-based compensation expense in fiscal 2007 includes an amount of \$20,505 for options granted to consultants (2006- \$6,400). Employee stock-based compensation expense is \$357,250 (2006 - \$425,427).

12 INCOME TAXES

The Company's effective tax rate differs from the combined federal and provincial income tax rate in Canada. This difference comes from the following items:

	2007 \$	2006 \$
Loss before income taxes	(2,638,265)	(2,295,133)
Income taxes calculated using the combined federal and provincial income tax rate in Canada of 36.12% (2006 - 36.12%)	(952,900)	(829,000)
Stock-based compensation	136,400	156,000
Other	3,800	50,100
Effect of changes in valuation allowance	617,700	544,500
Future income tax provision (recovery)	(195,000)	(78,400)

The future income tax assets and liabilities result from differences between the carrying amount and the tax basis of the following:

	2007 \$	2006 \$
Future income tax assets		
Non-capital losses	2,289,300	2,409,900
Intangible assets	989,300	989,300
Property, plant and equipment	99,700	90,700
Share issue costs	800	3,500
	3,379,100	3,493,400
Valuation allowance	(3,379,100)	(3,493,400)
Net future income tax asset	-	-

The Company has financed part of the start-up phase of renewable energy and energy conservation projects through the issuance of flow-through shares. Under the terms of the flow-through share agreements, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregoing tax benefits to the Company, the carrying value of the shares issued is reduced by the tax effect of the tax benefits renounced to subscribers. The tax effect of the renouncement is recognized on the date the Company files the renouncement documents with the tax authorities to renounce the tax

Financial Information (Cont'd)

credits associated with the expenditures, provided there is reasonable assurance that the expenditures will be made. During fiscal 2007, the Company renounced approximately \$540,000 (2006 - \$217,000) of expenditures. At May 31, 2007 and 2006 there are no expenditures that are required to be incurred before December 31, 2007. Participation in this program is subject to verification by tax authorities with respect to the nature and timing of expenditures.

As at May 31, 2007, the Company had available non-capital income tax loss carry forwards in the following amounts which may be used to reduce federal and provincial taxable income.

Year of Expiry	Amount \$
2009	1,086,000
2010	1,395,000
2014	355,000
2015	533,000
2026	1,276,000
2027	1,693,000
Total	6,338,000

13 OTHER REVENUE

	2007 \$	2006 \$
Gain on write-off of convertible debt, past President	-	329,823
Gain on write-off of commissions due to past President	-	36,548
Write-off of receivable from past President	-	(134,066)
Cancellation of convertible debentures	-	25,529
Gain on extinguishment of a liability	5,240	32,380
	5,240	290,214

In fiscal 2007, other revenue resulted from a gain on the extinguishment of a liability. In fiscal 2006, after review by the past President, creditors and the Company, in June 2005, an agreement was reached to reduce the resulting obligations to the past President.

14 OTHER COSTS

In fiscal 2007, costs incurred to remedy a design deficiency for a project were charged to other costs in the amount of \$36,001 (2006 - \$310,096).

15 SEGMENTED INFORMATION

The Corporation operates in one operating segment - energy conservation and environmental compliance (air) within North America. Within this business segment, the Corporation markets, sells, engineers, fabricates, constructs, installs and supports two retrofit technology lines - waste energy recovery solutions and air pollution control solutions. Revenue is derived mainly from engineering and constructing the complete retrofit energy recovery and air pollution control solution, with some revenue derived from the custom fabrication and assembly of the proprietary hardware components and the core major equipment package of the technologies. All assets are located in Canada.

Two unaffiliated customers accounted for 100% of sales in 2007 and in 2006. The Company continues to work aggressively with other partners and potential new partners to attract new customers.

16 FINANCIAL INSTRUMENTS

The following methods and assumptions were used to determine the estimated fair value of each class of financial instruments.

Short-term financial instruments

The fair value of the short-term financial assets and liabilities approximates their carrying amount given that they will mature shortly.

Loans receivable

The fair value of loans receivable, all of which have been granted to directors and officers, has not been determined because it is practically impossible to find financial instruments on the market having substantially the same economic characteristics.

Foreign exchange risk

The Company is exposed to foreign exchange risk due to cash, short term investments, accounts receivable and accounts payable denominated in U.S. dollars. As at May 31, 2007, cash, short term investments, accounts receivable and accounts payable denominated in U.S. dollars totalled US\$244,694, US\$300,000, US\$343,075 and US\$29,390 respectively (US\$1,852, US\$Nil, US\$Nil and US\$17,007 as at May 31, 2006).

The Company does not enter into arrangements to hedge its foreign exchange risk.

17 CONTINGENCY

On October 20, 2005 the Company announced that the voluntary mediation between the Company and its past President had ended without resolution. The Company has been served with a statement of claim for approximately \$4 million from its past President. The Company has filed its statement of defence and has filed a counter-claim seeking damages from the past President in the amount of \$5.4 million. The Company is confident in the merits of its own case and that the claim by the past President is frivolous and without merit and the Company will defend it vigorously. Accordingly, no provision for any potential loss has been recorded in connection with this claim.

18 COMPARATIVE FIGURES

Certain 2006 amounts have been reclassified to conform with the current period's presentation. This included stock-based compensation, previously presented separately in the Consolidated Operations and Deficit statement and which has now been included in the expenses to which it relates. In the year ended May 31, 2007, \$80,411 (2006 - \$285,387) was reclassified to Administration and \$297,344 (2006 - \$146,440) to Selling, marketing and business development.

Information for Shareholders

Board of Directors

John R. Parker, Chairman of the Board
Tim K. Angus
R. James Ansell
William Crossland
Clint Sharples
Michael Williams
John Kelly

Officers and Senior Management

Tim Angus
President & CEO

Denis Forget, P. Eng
Chief Operating Officer

Oliver Toffoli, P. Eng
General Manager & Chief Financial Officer

Robert Triebe, M.A.Sc., P. Eng
Chief Technology Officer

Anthony J. Pugliese
Vice President, Sales

Gustav Pliva
Manager, Corporate Development & Human Resources & Corporate Secretary

Auditors

Raymond Chabot Grant Thornton LLP

General Counsel

Heenan Blaikie LLP

Registrar & Transfer Agent

Computershare Investor Services, Inc.
100 University Avenue, 11th Floor
Toronto, ON M5J 2Y1
Tel: (416) 263-9496

Stock Listing

The common shares of Thermal Energy International Inc., are traded on the TSX Venture Exchange (www.tsxventure.com) under the symbol "TMG"

Investor Relations

Stuart McCarthy
stuart.mccarthy@thermalenergy.com
(613) 723-6776 x 220

Annual Meeting

The Annual Meeting of Shareholders will be held on:
Thursday, November 29, 2007, at 9:00 a.m. EST
Brookstreet Hotel in the Mulligan Room
525 Legget Drive,
Kanata, Ontario

Company Address

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